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TIME FOR A COMPLETE BAN ON ECONOMIC TIES WITH RUSSIA

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Introduction

More than two years into Russia's brutal war in Ukraine, the baseline scenario is now a war of attrition. Clearly, Ukraine cannot win this war without continued military and financial support from its partners in the West and elsewhere. It is also clear that too little has been done to limit the resources available to Russia to wage war against Ukraine and to debunk Russian propaganda (often parroted by Western media) that the Russian economy is unaffected by various sanctions levied by the G-7 and others. For instance, there is a common misperception that sanctions are "not working" and that they hurt the sanctioning countries more than Russia. This false narrative is largely due to the piecemeal implementation of sanctions and the problems with monitoring and enforcement of the sanctions that have been introduced. It is high time to change the resources available to Russia, the narratives around sanctions, and the reality for any Western company doing business in Russia.

In this essay we argue that the most effective way of addressing these issues is to introduce a full embargo on all business with Russia, including trade, investments, and finance—with a limited set of exceptions rather than a long list of what is sanctioned. "Shock and awe" should be the leitmotif of limiting Russia's economic capacity to wage war. Russia's horrific violence imposed on Ukraine qualifies Russia as a criminal state and is thus sufficient to make the moral argument for not doing business with Russian-based companies or individuals. However, there are also good political and economic arguments for this that will be discussed in more detail below.

CONTEXT FOR STRONGER SANCTIONS AGAINST RUSSIA

The characteristics of the Russian economy coupled with shortfalls in the implementation of a sanctions regime to-date invite a stronger, more comprehensive response from the international community. In this section, we identify six specific observations on the Russian economy and sanctions levied to-date, which collectively make the case for sanctioning countries to ramp-up their efforts against Russia.

To start, the notion of economic sanctions as a credible and effective tool rests on the assumption that the sanctioning coalition has the economic power to implement sanctions that cause meaningful economic pain for the sanctioned country. The lack of economic diversification in Russia essentially guarantees that effective sanctioning of key industries will cause disproportionate harm to their economy. Looking back on the real growth of the Russian economy for the last 30 years, three quarters of the expansion can be explained by one single variable: changes in international oil prices. This heavy dependence on oil revenues—and more generally on revenues from commodity exports—makes the Russian economy particularly vulnerable to sanctions. Targeting these sensitive sectors can substantially degrade Russia's economy.

Two, the cost of sanctions should always be larger for the sanctioned country than for the sanctioning countries. Fortunately, the modest size of the Russian economy is likely to assure this condition holds, as the GDP of the sanctions coalition is roughly 25 times that of Russia.[1] This means that for the sanctioning coalition, Russia only accounts for a few percent of the sanctioning coalition's exports and that every dollar of lost income due to sanctions hurts Russia more relative to sanctioning countries. Some point to the EU's dependence on imports of Russian energy in the form of gas and oil, but as has been seen in the EU, the major decoupling from Russian energy and trade has come with a price tag that is much smaller than some key policymakers in the EU argued before sanctions were introduced. There was no mass unemployment after EU effectively cut imports of Russian gas. In contrast, the Russian gas supplier Gazprom lost access to a $50 billion market and realized its first loss in over two decades (for comparison, the Russian military spending was approximately $140 billion in 2024).

Three, the sanctions imposed on Russia so far have been numerous (more than 4,500 entities and 11,500 individuals) and introduced over a long period of time. This makes the monitoring and implementation of sanctions complicated. The delayed implementation provided Russia with more time to adjust to and circumvent sanctions, while the effects of sanctions have been spread over time, often with a significant lag. The argument that has been used for this approach to sanctions is that the West should avoid the use of "nuclear" options; keep some sanctions "powder dry"; and avoid "high costs" in the sanctioning countries. Unfortunately, the slow pace, complex regulations, and patchy enforcement of implementing serious sanctions have provided Russia with some economic breathing space and thus blunted the effectiveness of sanctions.

Four, profit motives must be measured against the interests of taxpayers in Russia's trading partners. Currently, the vast bulk of the trade with Russia from Western countries is undertaken by *private* companies, and these private companies are motivated by *private* profits. As they do this, they also generate a surplus in the country they trade or invest in—which is how economists typically describe the benefits of trade across countries. However, in this case, the interest of private companies to earn profits also has to be measured against how much Western taxpayers will have to contribute to help Ukraine defend its territories, i.e., there are negative externalities that private businesses create that have to be accounted for when doing business with Russia. Kyiv School of Economics (KSE) and other sources indicate that in 2022 the non-sanctioned foreign firms in Russian generated approximately $200 billion in sales and $20 billion in profits while paying $20 billion in taxes to the Russian government. For comparison, more than $170 billion in economic and military aid was disbursed to Ukraine since the full-scale invasion and more billions were spent to support Ukrainian refugees (Germany alone spent about $20 billion in 2022-2023). Private and public interests are clearly colliding in the context of the Russian invasion and private companies are not shy about protecting their profits and investments (e.g., aid to Ukraine was delayed until Austrian Raiffeisen Bank and Hungarian OTP bank—two banks with large presence in Russia—were removed from Ukraine's list of terrorism sponsors). The argument that cutting ties with Russia will hurt jobs in the West may sound appealing at first, but "saving jobs" by trading with Russia is akin to protecting loggers' jobs in face of climate change. There may be reasons to help workers find new jobs if needed but not at the cost of keeping jobs that depend on doing business with a criminal state.

Five, the idea of "change through trade" (or "Wandel durch Handel" in German) is often a justification for maintaining trade with despicable regimes, but it has historically fallen short. This idea has clearly failed when it comes to Russia, but more generally there is little evidence that trading with rogue countries materially improved political behavior or practices. Saddam Hussein's Iraq, North Korea, China, and the Soviet Union did not really alter their behavior because they were afraid of losing gains from trading with the West. If anything, trade with terrible regimes extended the lives of these regimes (e.g., Lybia, Iraq, USSR, and South Africa) and introduced opportunities to corrupt the West (e.g., the infamous "oil for food" program with Saddam Hussein or Gazprom deals with Gerhard Schroeder). On the other hand, trade bans did curtail the ability of rogue regimes to wage aggression: North Korea can't mass produce nuclear weapons, Cuba does not send troops to Africa anymore, and Iraq did not have resources to produce weapons of mass destruction.

Lastly, sanctions are working. For example, when Western manufacturers left Russia, car production declined by more than 60% in 2022. Russian GDP fell by 2% after the first rounds of sanctions were introduced in 2022. However, this was a year when oil prices went up by more than 40% compared to the average price in the previous year; in a typical year, this would have led to Russian GDP growth on the order of 6 to 8%. This baseline growth suggests that sanctions reduced GDP growth by 8 to 10 percentage points, a rather significant effect. At the same time, it is difficult to assess precisely how sanctions hurt the Russian economy because the Russian government selectively picked what numbers to publish and, on top of that, what the number should be in order to maximize the Russian narrative regarding sanctions. Take inflation as an example: It is claimed to be around 7%. However, the central bank of Russia keeps its policy rate at 16% while the currency went from 50 rubles per dollar to 90 between the summer of 2022 and early 2024. In short, the published inflation rate has a low level of credibility but serves the narrative that things in Russia are "normal." The West should not rely on fantasy numbers from Russia when it evaluates the impact of sanctions and more generally stop obsessing with these calculations as a substitute for introducing a full set of economic sanctions.

Proposal

To accelerate the degradation of the Russian economy and to dampen Putin's ability to wage war in Ukraine, we propose that the Western partners of Ukraine stop doing business with Russia altogether—with only limited exceptions for humanitarian considerations. Implementing this policy can be as simple as a directive from of the U.S. Office of Foreign Assets Control (OFAC), similar to that issued for companies interested to trading with North Korea:

> Pursuant to 15 CFR 746.4(a), a license from the Department of Commerce is required to export or reexport any item (commodities, software, or technology) subject to the EAR [Export Administration Regulations] to North Korea, except food and medicine designated as EAR99, unless a license exception applies.

This approach can help address various challenges identified in our observations above. For example, keeping sanctions simple is a key part of this proposal. It should be clear in all board room discussions that doing business in, or with, Russia is not an option if the company seeks to do business with the West. It also establishes to customs official and financial intermediaries that any transactions with Russia should be scrutinized, with an assumption that if it is not explicitly allowed through an exemption, it is banned. This will simplify decisions for Western executives and bankers, while complicating efforts by those who engage in sanctions circumvention.

The full ban reduces the ability of private interests to lobby for exemptions and thus breed corruption and undermine the effectiveness of sanctions. We envision that the list of companies allowed to do business in or with Russia should be on public display to ensure transparency and oversight as well as to limit opportunities for corruption. One can expect that few things are really needed on the exception list, which could include certain foods and medicines, but not everything in these categories should be on the list, in particular not dual-use items. Indeed, it is hardy critical to supply Russia with Maybach luxury cars, Nestle's Nescafe, or Computer Numerical Control (CNC) machine tools.

Companies should also be required to disclose their Russian connections (e.g., trade, investment, patents, and ownership) as a materially important risk in public reporting. In short, the onus should be on firms to prove the need to maintain economic ties with Russia.

The "full sanction" mode also allows Western companies to get out of contractual obligations with Russia. In a nutshell, the companies can claim force majeure and cancel their contracts with Russian counterparties. Western laws (e.g., the U.K. Sanctions and Anti-Money Laundering Act 2018) typically stipulate that companies cannot be held liable if their act of not meeting contractual obligations is in compliance with sanctions regulations. Furthermore, it will reduce the exposure of Western companies with Russian connections to mass civil legal action to compensate victims in Ukraine.[2] In other words, the proposed approach would facilitate the exit of Western companies from Russia. More importantly, this approach will make it clear to the public both in the West and in Russia that nothing is "normal" in the relationship with a country that commits war crimes in a peaceful neighboring country.

Impact

Western exports are still contributing to the Russian economy and its ability to supply the Russian war machine. This is not only through goods that directly enter the production of military equipment but also through the revenues they generate to the Russian budget and incomes in the economy more generally through standard multiplier effects that come with imports. In collaboration with Yale Chief Executive Leadership Institute, the KSE is documenting foreign firms in Russia to determine who is staying and who is leaving. In short, many companies have left or announced that they are curtailing operations, but several companies have done nothing and instead keep operation as "normal." The exact numbers differ somewhat depending on the source, but KSE notes that a minority of firms (358) have left Russia altogether while a majority of firms that were in Russia before 2022 are still active in Russia in some capacity (2,138). At the same time, Western firms outside of Russia are still exporting to Russia: Although exports from the EU to Russia has already been cut in half, there is still the other half to go. Many Western companies simply continue doing business with Russia with the argument that the goods and services they provide are not on the sanctions list.

In contrast, only a handful of American companies have ties to Syria, Iran, Cuba, North Korea, and Sudan—countries that are fully embargoed by the U.S. government. Those who tried to bypass the embargoes paid hefty fines.[3] This proposal will end the "business as usual" posture by some Western companies towards Russia, redefining the relationship to resemble the one between U.S. firms and countries that face comprehensive embargoes.

The experience of a "full ban" applied to North Korea suggests that such sanctions can be effective in limiting rogue countries in their ability to wage wars and other forms of aggressive behavior. Protocols established for North Korea and the likes can be readily applied to Russia. For example, the most basic "Know Your Customer" (KYC) or due diligence checks have been instrumental in closing loopholes for Pyongyang to obtain resources for its nuclear program. Applying a similar approach can help minimize Russian trade via Turkey, Kyrgyzstan, Georgia, and other proxies. Banks have been doing KYC for years, and other businesses including high-tech firms should be able to do the same.

When it comes to Russia's energy export in general and oil in particular, we would argue that a full embargo by the West makes perfect sense, in particular if this is seen in light of a price cap on Russia's oil export to other countries that are not part of the sanctions coalition. With better enforcement of the price cap and an eventual push for a lower price cap, this will have a significant impact on the resources available to Russia without upsetting the global oil market. Given Russia's dependency on its oil revenues, both for foreign exchange and income to the government's budget, the risk that Russia would stop supplying the global market with oil is very limited and any threats to do so should be met with a high degree of skepticism.[4]

Even if this minimal risk were to materialize, we would argue that the impact on the global economy would be limited for several reasons. To start, Russia accounted for around 11% of global oil exports in 2022, and in the early days of the invasion, some observers (e.g., Pierre Andurand) predicted that the price of oil could reach $250/barrel if Russia did not export its oil. While a possibility, this scenario does not appear likely to us. First, Russia will continue to ship oil to China and other allies. Thus, not all oil will be taken off the market. Furthermore, because the set of buyers will likely become more limited with stricter sanctions, Russia will have to offer even more generous discounts to the remaining buyers thus reducing Russian revenues and depressing global oil prices rather than increasing them.

Second, if price increases were to materialize because, for example, China and others would at some point join the policy of the West and not buy Russian oil, such price increase must be accepted by OPEC+. The cartel has repeatedly signaled that its preferred price is between $80 and $90 per barrel. In early 2024, Russia exported 3.7 million barrels per day. U.S. Energy Information Administration (EIA) estimates that OPEC has space capacity of about 4 million barrels per day. Thus, OPEC can fully substitute for Russian oil.

Third, learning from history, economic sanctions reduced Iran's oil exports from 2.2 million barrels per day in 2012 to 1.0 million barrels per day in 2015. At the same time, the price of oil (Brent) collapsed from $110 in 2012 to $52 in 2015. Of course, this does not mean that sanctions reduce the price of oil, but these dynamics suggest that many factors are at play and removing a major exporter from the market does not work as linearly as some observers think.

Finally, the decoupling of the European Union from Russian gas suggests substitution as a strong force that can mitigate the adverse effects from potential increases of oil prices. Specifically, Bachmann et al. (2022)[5] predicted in March 2022 that the loss of Russian gas would not result in an economic catastrophe because the elasticity of substitution is far from zero. Their forecasts turned out to be correct, while the politicians and energy executives who predicted "mass unemployment" were way off in their predictions.

Concluding remarks

Few concrete alternatives to sanctions have been put forth. It is time to turn the tables and finally implement full economic sanctions against Russia to ensure that the desired effect comes sooner rather than later. Introducing piecemeal sanctions is like squeezing a balloon in the middle and not expecting it to expand at the ends. The Russian economy needs to be squeezed from all ends to limit the resources available to wage the war in Ukraine.

The full ban delivers this objective with several desirable features. First, the democratic world should not trade with a country run by war criminals that commit atrocities on a daily basis. Second, a full-scale trade sanctions regime creates less bureaucracy and is easier to monitor for the authorities and simpler for companies to understand than an ever-growing list of items that are sanctioned. This is particularly important as ways to prevent sanction circumvention is high on the policy agenda in the sanctions coalition. Third, the ban will diminish Russia's capacity to wage war because Russia critically depends on the global economy and foreign technology. Fourth, the economic costs of an export ban for the sanctions coalition will be limited. Fifth, the ban will correct the negative externality generated by individual companies doing business with Russia. Finally, it will send a strong signal to other countries that attacking a peaceful neighbor will come at a high economic cost. This could save enormous sums by averting wars.

Russia is today an aggressive totalitarian state with significant resources. However, even dictators must respect budget constraints, and we should ensure that these constraints are as tight as possible. Ending Western companies' business relations with Russia is an important step in this direction.

Endnotes

1 This is due to the inadequate economic policies implemented by the Russian regime since the breakup of the Soviet Union in 1991, which has left Russian households far behind citizens in the sanctioning coalition in terms of per capita incomes or purchasing power. This lackluster performance is striking given the fact that oil prices have risen from around $10 per barrel at the end of the 1990s to around $90 per barrel in early 2024.

2 Ukraine would be hardly unique in this context. For example, in 2019, Israeli victims of Palestinian terror attacks filed a $5.8 billion compensation suit against Arab Bank PLC, claiming it knowingly supported and financed terror groups that carried out attacks that claimed hundreds of lives. In 2021, Gold Star Families accused (seeking billions of dollars in damages) Deutsche Bank, Standard Chartered, and other banks of aiding terrorists (the banks ignored warnings that their customers were helping to finance attackers targeting Americans in Afghanistan.)

3 For example, Schlumberger, an American oil company, paid a $233 million fine for violating U.S. sanctions related to Iran and Sudan. BNP Paribas, a French bank, admitted guilt and paid $8.9 billion for illegally processing financial transactions for countries subject to U.S. economic sanctions.

4 In this context, Johnson et al. (2023) argue that the supply curve for Russia can be downward sloping. See Simon Johnson, Lukasz Rachel, and Catherine Wolfram, 2023. "A Theory of Price Caps on Non-Renewable Resources," NBER Working Paper 31347, National Bureau of Economic Research.

5 Bachmann, R., D. Baqaee, C. Bayer, M. Kuhn, B. Moll, A. Peichl, K. Pittel and M. Schularick (2022), "What if? The Economic Effects for Germany of a Stop of Energy Imports from Russia", ECONtribute Policy Brief 28/2022.

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